Information from the Division of Health Care Finance and Policy

Quarterly Acute Hospital Financial Report, FY07 Q1

In Fiscal Year 2007, Quarter 1 (FY07 Q1), hospital industry profitability improved from Fiscal Year 2006 Quarter 1 (FY06 Q1) levels. This increase is mostly attributable to operating margin performance. In addition, fewer hospitals showed total losses in FY07 Q1. Most of the hospitals (85%) continued to comfortably meet short-term obligations, and days in accounts receivable and average payment period also continued to improve. Finally, solvency was stable for the majority of the industry; however, the ability to cover long-term obligations remained a concern for just over one-quarter of Massachusetts acute hospitals.

About this Report

The Division of Health Care Finance and Policy (the Division) publishes quarterly acute hospital financial reports in response to a legislative mandate to provide an annual assessment of financial trends in the acute care hospital industry. Quarterly reporting is one part of the Division's ongoing program to inform and protect the public interest by continuously monitoring the financial condition of acute care hospitals. This report presents an industry-wide analysis from FY03 through FY07 Q1.[1] Financial trends for individual hospitals are available on each hospital's Fact Sheet in the DHCFP Data Catalog at www.mass.gov/dhcfp.

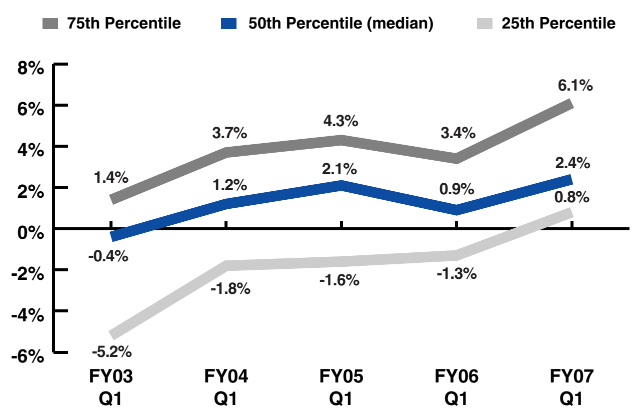
Trends in financial ratio analysis can provide useful information about the hospital industry's financial condition. The three areas examined on a quarterly basis and discussed in this report are profitability, liquidity, and solvency.[2] In addition, we present these three areas by hospital teaching status.

Profitability

Although most Massachusetts acute care hospitals are non-profit, they need to generate a sufficient surplus in order to fulfill their missions, repay debt, and invest in the future of their organizations. Therefore, an analysis of the industry's profitability using three key ratios is reported here. Figures 1, 2, and 3 show FY03 Q1 through FY07 Q1 trends for 25th,

Figure 1

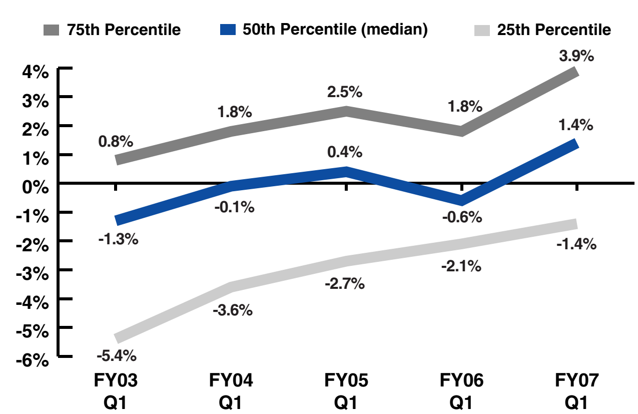
Total Margin Trend, FY03 Q1-FY07 Q1



- **Overall profitability improved in FY07 Q1 primarily due to operating performance, with fewer hospitals experiencing losses.**

Figure 2

Operating Margin Trend, FY03 Q1-FY07 Q1

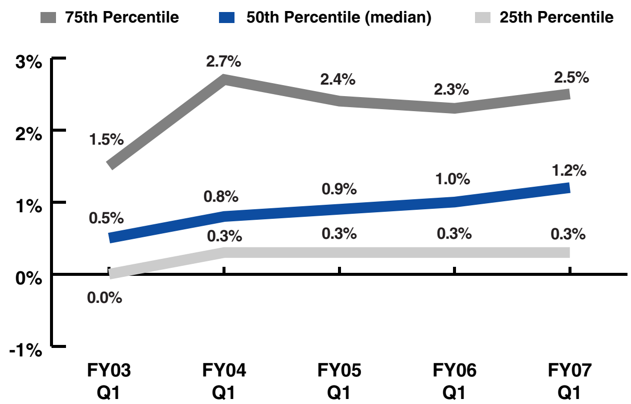


- **Operating performance improved across the industry in FY07 Q1.**

Sarah Iselin, Commissioner • Division of Health Care Finance and Policy • 2 Boylston Street • Boston, MA 02116
phone: 617-988-3100 • fax: 617-727-7662 • publications: 617-988-3125 • www.mass.gov/dhcfp

Figure 3

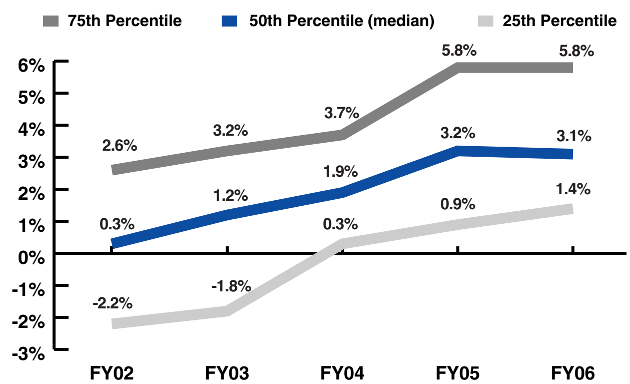
Non-operating Margin Trend, FY03 Q1-FY07 Q1



- **Non-operating Margins improved slightly across two quartiles and remained stable in the third quartile in FY07 Q1.**

Figure 4

Annual Total Margin, FY02-FY06



- **Annual Margins are provided as a reference.**

50th (median), and 75th quartile values[3] for Total Margin,[4] Operating Margin,[5] and Non-operating Margin.[6]

Profitability often dips in the first quarter of each year due to seasonal drops in utilization, however, in FY07 Q1 profitability improved over the first quarter in previous years (see Figures 1 and 2). Total margin showed improvement across all quartiles in FY07 Q1, primarily due to improvements in operating margins. Non-operating margins showed a minor improvement in two quartiles and remained stable in the lowest quartile in FY07 Q1 compared with FY06 Q1. In addition, fewer hospitals (14) showed total losses compared to FY06 Q1 (24 hospitals). For reference, Figure 4 provides annual measures of total profitability.

Liquidity

Liquidity ratios indicate a hospital's ability to meet its short-term obligations. Deterioration of these ratios is one indication of financial stress. Three liquidity ratios are reported here: Current Ratio,[7] Average Days in Accounts Receivable (A/R),[8] and Average Payment Period.[9] Figures 5, 6, and 7 show trends in quartile values for these three ratios.

The ability of the hospitals to meet current obligations remained fairly stable in FY07 Q1 compared with FY06 Q1. Most hospitals (85%) performed above the 1.0 minimum benchmark in FY07 Q1 (see Figure 5).[10] In addition, the industry continued a trend towards more efficient management of Days in A/R (see Figure 6). Average time to pay current liabilities also showed slight improvement in FY07 Q1 (see Figure 7) across all quartiles. However, nearly one-fourth of hospitals paid current obligations in a shorter time frame than they collected payments, which could lead to cash flow constraints for this group of hospitals in the future.

Solvency

Solvency ratios provide information regarding how an organization finances its assets and how able an organization is to take on new debt. Deterioration of these ratios is another indication of problems in the financial health of an organization. Solvency ratios of Debt Service Coverage and Cash Flow to Total Debt are not included in this report because annualized data are necessary to accurately present these ratios. For quarterly analysis, only one solvency ratio is reported: Equity Financing.[11]

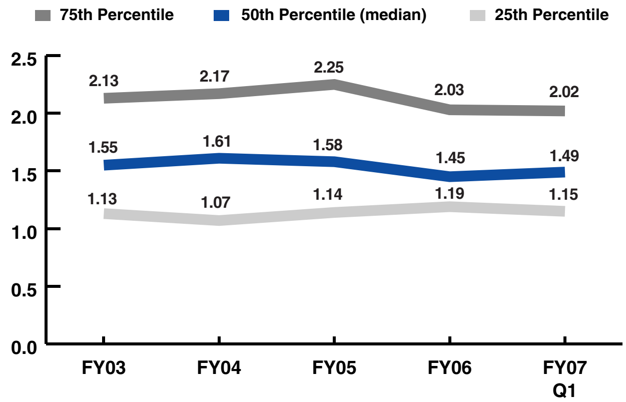
The Equity Financing ratio, measured by the proportion of total assets financed by equity, reflects the potential for a hospital to take on more debt. Low values indicate that a hospital is highly leveraged, and therefore, may have difficulty securing access to debt financing for further asset acquisition or capital improvements. Equity Financing showed slight improvement across all quartiles in FY07 Q1 over FY06 Q1 (see Figure 8); however this ratio was below the 30% industry benchmark for 26% of the hospitals, indicating long-term solvency issues for this group.

Teaching versus Non-teaching Hospitals[12]

The Division also compares the financial health of teaching and non-teaching hospitals using financial ratio analysis. In

Figure 5

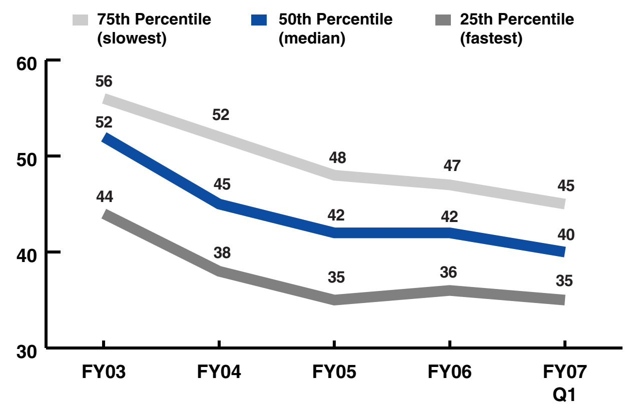
Current Ratio Trend, FY03-FY07 Q1



- Current Ratio remained fairly stable across the industry with most hospitals (85%) maintaining Current Ratios above the 1.0 benchmark in FY07 Q1.

Figure 6

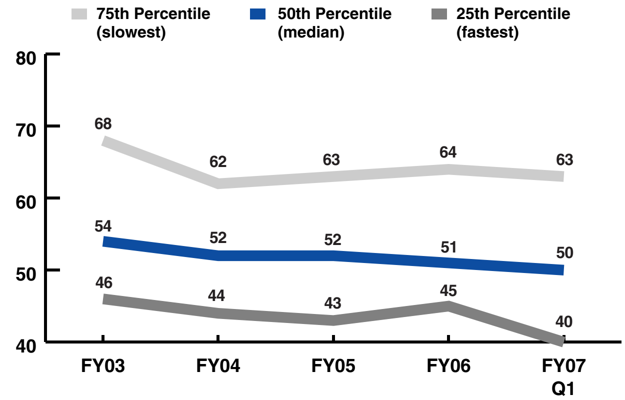
Days in Accounts Receivable Trend, FY03-FY07 Q1



- Following the industry's positive trend since FY03, hospitals continued to improve collection of receivables in FY07 Q1.

Figure 7

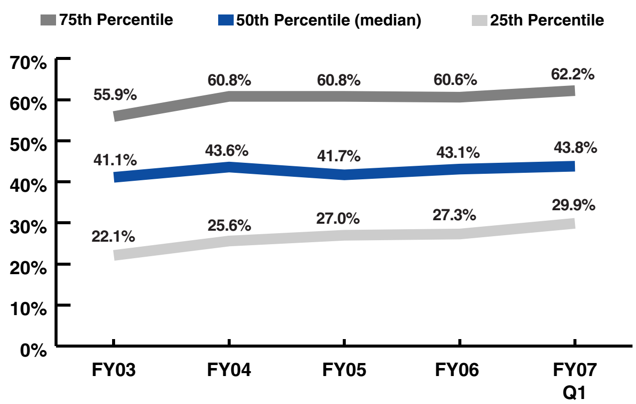
Average Payment Period Trend in Days, FY03-FY07 Q1



- Average Payment Period decreased across all quartiles in FY07 Q1; however, 26% of hospitals paid current obligations at a faster rate than they collected receivables.

Figure 8

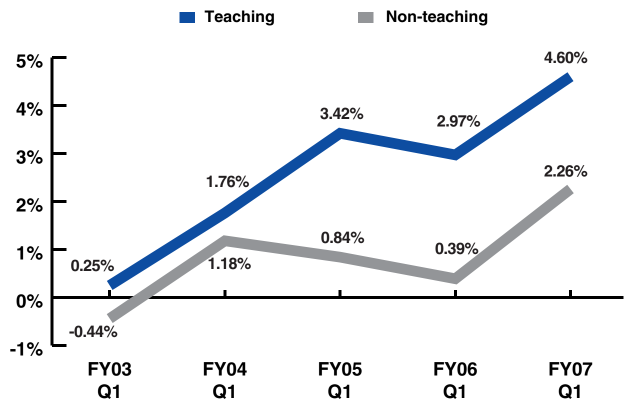
Equity Financing Trend, FY03-FY07 Q1



- Equity Financing Ratios improved slightly for most of the industry in FY07 Q1; however, 26% of the hospitals were below the 30% benchmark. The highly leveraged position of some hospitals may make future asset acquisition difficult for this group.

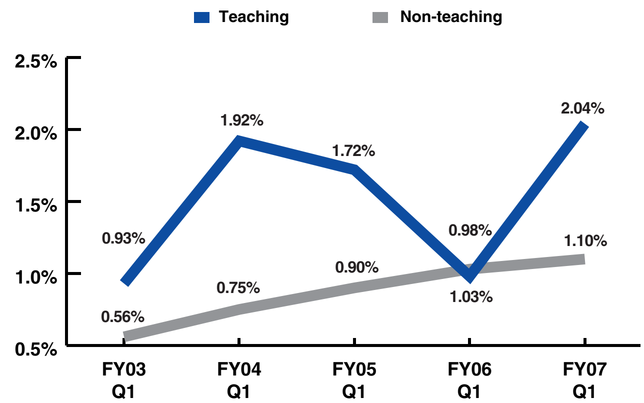
terms of total and operating profitability, teaching hospitals outperformed non-teaching hospitals, with a lower percentage of teaching hospitals experiencing overall losses (7% compared with 26% for non-teaching hospitals). In terms of non-operating performance, the highest quartile of teaching hospitals showed much higher average non-operating ratios (5.3%) compared to the highest quartile of non-teaching hospitals (2.3%). The median total margins for teaching and non-teaching hospitals were higher in FY07 Q1 compared with FY06 Q1 (see Figure 9). In the case of teaching hospitals, most of this improvement was due to an increase in the median non-operating margin. The decrease in teaching hos-

Figure 9
Median Total Margin, FY03 Q1-FY07 Q1



- **Total margin improved in FY07 Q1 compared with FY06 Q1 for both teaching and non-teaching hospitals.**

Figure 10
Median Non-operating Margin FY03 Q1-FY07 Q1



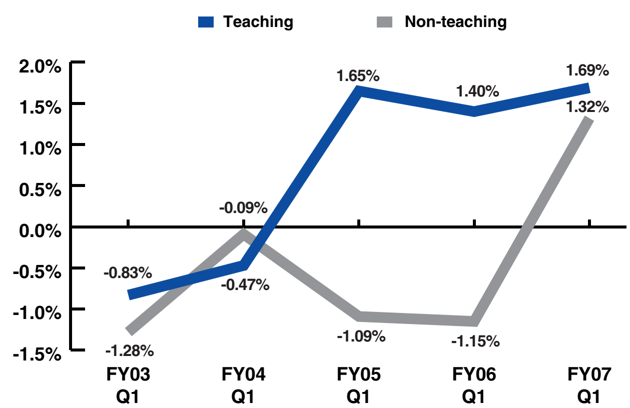
- **The decrease in teaching hospitals' non-operating median margin between FY05 Q1 and FY06 Q1 may be the result of some hospitals moving investments to their parent company.**

pitals' median non-operating margin between FY05 Q1 and FY06 Q1 may be the result of some hospitals moving investments to their parent company (see Figure 10). In the case of non-teaching hospitals, most of the improvement was due to an increase in median operating margin. For the first time in the past five first quarters, non-teaching hospitals experienced a positive operating margin in FY07 Q1 (see Figure 11).

Results were mixed with regard to liquidity. Median Current Ratio was slightly higher for non-teaching hospitals, but in the upper quartile of hospitals, teaching hospitals were stronger. In addition, a higher percentage of teaching hospitals (27%) versus non-teaching hospitals (12%) experienced Current Ratios below the minimum industry benchmark of 1.0. Non-teaching and teaching hospitals had comparable performance in collecting receivables and paying current obligations with the median average payment period slightly less for non-teaching hospitals.

Non-teaching hospitals may have more difficulty meeting interest and principal payments in the upcoming year as 30% (versus 13% for teaching hospitals) were below the 30% benchmark for Equity Financing in FY07 Q1. However, this was an improvement over FY06 Q1 when 35% of non-teaching hospitals experienced equity financing ratios below the benchmark.

Figure 11
Median Operating Margin, FY03 Q1-FY07 Q1



- **For the first time in five consecutive first quarters, non-teaching hospitals experienced a positive median operating margin.**

Summary
Overall profitability improved in FY07 Q1, primarily due to operating performance. Profit levels were higher in FY07 Q1 than they were in FY06 Q1 with fewer hospitals experiencing losses. Current ratios remained fairly stable, with a slight dip in the lowest quartile hospitals. A majority of hospitals (85%) were able to meet their current obligations. In addition, management of receivables and payment periods improved across the industry. Finally, solvency was stable for most of

the industry; however, the ability to cover long-term obligations remained a serious concern for 26% of Massachusetts hospitals.

Financial ratio values for each hospital are on the Hospital Fact Sheets in the Division of Health Care Finance and Policy Data Catalog at www.mass.gov/dhcfp. Hospital-specific dollar surplus or loss, net patient service revenue, total net assets, and assets whose use is limited are also provided on the Hospital Fact Sheets illustrating the magnitude of hospital surplus and loss, the size of operation, and the size of reserves.

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[1] The FY07 Q1 findings in this report are based on the financial filings of 65 acute care hospitals. Most hospitals have a fiscal year ending September 30. Cambridge Health Alliance, MetroWest Medical Center and Saint Vincent Hospital have a fiscal year ending on June 30. Martha's Vineyard Hospital's fiscal year ends on March 31. Data for Mercy Medical Center were not yet submitted because their fiscal year ends later (on December 31).

[2] Depending on the organization of each hospital, data may exclude other aspects of some hospitals' financial health, such as performance of endowments or the financial health of parent or other affiliated organizations.

[3] Quartile values can shed light on information about the distribution of financial ratio values across hospitals. Often, averages can be materially affected by outlier/extreme values at the low and high ends of a distribution. Examining quartiles, therefore, is a preferred means of assessing the overall distribution of values across hospitals. For instance, the ratio values of one-quarter of the hospitals at the lower end of the distribution will fall at or below the 25th quartile value. Similarly, the ratio values of one-quarter of the hospitals at the upper end of the distribution will fall at or above the 75th quartile value. The 50th percentile is the median of the distribution of values. Half of the hospitals' financial ratio values will fall below the median, and half will fall above the median. These quartile measures are particularly useful when a distribution is markedly skewed, or where it is generally symmetrical but includes a few outliers.

[4] Ratio of total income to total revenue.

[5] Ratio of operating income to total revenue.

[6] Ratio of non-operating income to total revenue.

[7] Ratio of current assets to current liabilities.

[8] Ratio of net patient accounts receivable to net patient service revenue/quarters of data * 91.25.

[9] Ratio of current liabilities less estimated third-party settlements to total expenses less depreciation and amortization/quarters of data * 91.25.

[10] A Current Ratio value of 1.0 indicates that a hospital has one dollar held in current assets per dollar of current liabilities. Values below 1.0 are considered strongly unfavorable and highlight an organization's illiquid position.

[11] Ratio of total net assets to total assets.

[12] According to the Medicare Payment Advisory Commission (MEDPAC), a major teaching hospital has at least 25 FTE residents per 100 inpatient beds. For this report, teaching status was determined according to the MEDPAC definition and was based on FY06 hospital cost report data submitted to the Division by the hospitals.

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